

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 91-096-W - ORDER NO. 91-881
OCTOBER 14, 1991

IN RE: Application of Heater Utilities,)
 Inc., for approval of adjustments) ORDER APPROVING
 in its rates and charges for water) RATES AND CHARGES
 service.)

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of an Application of Heater Utilities, Inc. (the Company or Heater) for approval of a new schedule of rates and charges for its customers in South Carolina. The Company's April 15, 1991, application was filed pursuant to S.C. Code Ann. §58-5-240 (1976), as amended, and R.103-821 of the Commission's Rules of Practice and Procedure.

By letter dated April 26, 1991, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing and Hearing, one time, in a newspaper of general circulation in the area affected by the Company's application. The Notice of Filing and Hearing indicated the nature of the Company's application and advised all interested parties desiring participation in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise required to notify directly all customers affected by the proposed rates and charges.

Petitions to Intervene were filed on behalf of Steven W. Hamm, the Consumer Advocate for the State of South Carolina (the Consumer Advocate) and Terry O. Hicks.

The Commission Staff made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The other parties likewise conducted their discovery in the rate filing of Heater.

A public hearing relative to the matters asserted in the Company's application was held on September 5, 1991, in the Hearing Room of the Commission at 111 Doctor's Circle, Columbia, South Carolina. Pursuant to S.C. Code Ann. §58-3-95 (Cum. Supp. 1990), a panel of three Commissioners composed of Commissioners Yonce, Bowers, and Arthur was designated to hear and rule on this matter. Darra W. Cothran, Esquire, represented the Company; Carl F. McIntosh, Esquire, represented the Consumer Advocate; and Marsha A. Ward, General Counsel, represented the Commission Staff.

The Company presented the direct testimony of William E. Grantmyre, President of the Company; Freda Hilburn, Director of Regulatory Accounting; and David Parcell, Vice President/Senior Economist of Technical Associates, Inc. to explain the services being provided by the Company, the financial statements and accounting adjustments submitted, the reasons for the requested rates, and the cost of capital requirements. The Company submitted rebuttal testimony from these same witnesses, as well as Jo Ann Journigan, Director of Finance. The Consumer Advocate presented

the testimony of Philip E. Miller, Riverbend Consulting, who analyzed the Company's application and revenue requirements. Terry O. Hicks did not appear at the hearing. The Commission Staff presented the testimony of Charles A. Creech, Chief, Water and Wastewater Department, and Thomas L. Ellison, Public Utilities Accountant. One protestant, René Bickley, a customer in Oakridge Hunt Club, testified in opposition to the proposed increase.

FINDINGS OF FACT

1. The Company is a wholly-owned subsidiary of Topeka Group, Inc.¹ The Company is a water utility operating in the State of South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 (1976) et seq. Application of Company; Grantmyre testimony.

2. The Company provides water service to approximately 3,183 customers in Richland, Lexington, Sumter, Fairfield, and Saluda Counties, South Carolina. Application of Company; Hearing Exhibit No. 7, Water and Wastewater Department, Part E.

3. The Company's present rates and charges were approved by Order No. 87-1193, dated October 27, 1987, in Docket No. 86-510-W. Hearing Exhibit No. 7; files of the Commission.

4. At present, the Company charges a basic facility charge of \$7.00 per single family equivalent and a commodity charge of \$2.68 per 1,000 gallons used. The Company also charges a tap fee

1. The Topeka Group, Inc. is a wholly owned subsidiary of Minnesota Power and Light Company.

of \$500.00 per single family equivalent.² The Company does not propose to change its tap fee. The Company proposes to change its water reconnection fee of \$30.00 to \$35.00 and increase its new customer account charge from \$22.00 to \$25.00. The Company proposes to increase its basic residential water rate to \$9.00 per month for meter sizes less than one inch³ (most residential units have a three-quarter inch meter), plus a commodity charge of \$3.48 per 1,000 gallons. Based on the average consumption of 6,481 gallons, the water increase amounts to an additional \$7.39/month or an increase of 30.32%. Application of Company; Hearing Exhibit No. 7, Water and Wastewater Department, Parts A, B, and C.

5. The Company asserts this requested rate increase is required because the Company has experienced substantial increases in operating expenses such as property tax expense, chemicals for water treatment, testing fees including the VOC monitoring required by the Safe Drinking Water Act, postage, DHEC annual operating permit fees, materials and supplies, increased field service operations due to the requirements of the Safe Drinking Water Act and operating expenses. The Company has experienced for the test year ending December 31, 1990, after accounting and pro forma adjustments a loss of \$163,488, after interest expense. The operating margin after interest expense under current rates after

2. Except as otherwise prohibited by contract approved by the Commission.

3. This charge increases as the meter size increases to a 2-inch meter.

accounting and pro forma adjustments was (17.28%). Since the end of the September 30, 1986, test year of the Company's last rate increase, Heater has invested funds for capital improvements totaling more than \$1.8 million for capital plant additions required to maintain and improve the quality of service and meet the more stringent requirements of the Safe Drinking Water Act and DHEC's rules and regulations. The Company asserts that the rate increase is necessary in order for it to earn a fair rate of return on its investment, which is necessary to maintain the financial integrity of the Company. The rate increase will enable the Company to maintain the quality of service to the customers and maintain customer satisfaction. Grantmyre testimony; Application of Company, revised Exhibits E and K.

6. The Company proposes that the appropriate test period to consider its requested increase is the twelve-month period ending December 31, 1990. Hilburn testimony; Application of Company. The Staff concurred in using the same test year for its accounting and pro forma adjustments. Ellison testimony, Hearing Exhibit No. 7. The Consumer Advocate concurred with the December 31, 1990, test year. Miller testimony.

7. Under its presently approved rates, the Company states its operating margin after interest and after accounting and pro forma adjustments is (17.28%). Application of Company, Revised Exhibit K. The Company seeks an increase in its rates and charges for water and sewer service which would result in operating margin of 5.48%. Application of Company, Revised Exhibit K.

8. Under the Company's presently approved rates, the Company states that its operating revenues for the test year, after accounting and pro forma adjustments, are \$945,922. The Company seeks an increase in its rates and charges for water and sewer service in a manner which would increase its operating revenues by \$273,300. Application of Company, Revised Exhibit C.

9. Under the Company's presently approved rates, the Staff found that the Company's per book operating revenues for the test year were \$949,584, after accounting and pro forma adjustments. The Staff calculated the proposed increase to be in the amount of \$275,733. The Company concurred with all of Staff's adjustments except those dealing with the Company's capital structure and the resulting impact on interest expense. Hearing Exhibit No. 7, Accounting Exhibit A; Testimony of Grantmyre.

10. The Company asserts that under its presently approved rates, its total operating expenses for the test year, after accounting and pro forma adjustments are \$963,961. Application of Company, Revised Exhibit C. Staff concluded that the Company's operating expenses for the test year, after accounting and pro forma adjustments, are \$956,055. Hearing Exhibit No. 7. Staff arrived at this proposal after making its adjustments to the Company's expenses. Based on the Company's concurrence with Staff's adjustments, except those dealing with Heater's capital structure, the Commission need only address those adjustments where the Company, the Staff and the Consumer Advocate disagree.

A. RATE CASE EXPENSES

The Consumer Advocate and the Staff agreed in their prefiled testimony that only the actual rate case expenses be amortized over three years. This amounted to an annual amortization of \$2,251. The Company presented additional documentation at the hearing (See, Hearing Exhibit No. 1) which supported additional actual rate case expenses amounting to \$5,993. Rebuttal testimony of Hilburn.

B. DEPRECIATION EXPENSE

The Consumer Advocate did not accept the Company's proposed depreciation expense adjustment because witness Miller did not have access to the accrual rates used by the Company and to the depreciable plant amounts at the end of the test year. The Commission Staff, however, did have access to the information and made several adjustments to the Company's depreciation expense. Witness Journigan stated that the Consumer Advocate would be able to access the information now that the depreciation schedules have been computerized.

The Staff recorded the effects of annualizing depreciation expense. Staff annualized depreciation on Plant Under Construction which was in progress at year end but had been booked to plant. Staff's adjustment includes depreciation on the total cost of such projects. Also, Staff corrected a Company error by subtracting only the depreciation expense of disposed property instead of subtracting total disposals from depreciation expense. Staff adjusted depreciation expense by \$44,850. Staff additionally removed depreciation expense on donated plant from expenses,

reducing depreciation expense by \$38,171, and removed the amortization of the acquisition adjustment from per book expenses in conjunction with the donated plant adjustment. This amounted to increasing depreciation expense by \$30,024. Testimony of Ellison; Hearing Exhibit No. 7.

C. REPLACEMENT COST ALLOWANCE AND EXCESS CAPACITY

The Consumer Advocate proposed that the Company's replacement cost allowance should be denied. The Consumer Advocate points out that such an allowance permits the Company to begin to recover the cost of plant that was not purchased by it. Also, according to witness Miller, it would allow depreciation expense on plant that is not in the rate base and, in his opinion, would violate the generally accepted ratemaking standard of matching revenues and expenses.

Heater responded to this issue through the rebuttal testimony of witness Grantmyre. First, Mr. Grantmyre addressed the Consumer Advocate's proposal to use the 23% calculation for the replacement cost allowance to reduce depreciation on cost plant and interest expense related to cost plant. As witness Grantmyre explained it is not appropriate to reduce cost depreciation and interest expense by 23% for the following reasons:

- (1) The cost plant excess capacity is considerably less than 23% since the replacement cost allowance excess capacity adjustment is calculated based upon the number of customers to be served by distribution mains as shown on approved DHEC plans and not the production, storage and water treatment capacities 82.4% of which were paid for by Heater as cost plant; (2) Most of the mains were contributed by developers and the replacement cost allowance for contributed plant has already been reduced by this 23%; (3) Virtually all of the cost plant of

Heater is used and useful in providing service to existing customers; and (4) it is reasonable to expect some excess capacity in cost plant in order to insure orderly growth and quality service. Grantmyre Rebuttal Testimony, pp. 3-4.

Mr. Grantmyre further pointed out that

...even though there are distribution mains in place to serve more than the existing customers, these mains are used to transport water to existing customers. For example, if there is a subdivision in which 75% of the lots are developed, you have 25% of the mains which do not serve a residence directly in front of these mains. However, these mains totaling 25% are absolutely essential to carry the water past these vacant lots to the lots further down the water main that have houses and customers. Without these mains the customers absolutely could not be provided water service.

With regard to the remaining utility assets such as wells, pumps, storage facilities, treatment equipment, transportation and communications equipment, they are all clearly used and useful in providing service to existing customers. The order cited by Mr. Miller on page four of his testimony (Order No. 91-367 in TCU, Inc., Docket No. 90-287-W/S dated May 17, 1991) excluded interest expense on a loan and depreciation expense for a sewer treatment plant which was not treating sewage and was not used and useful. The Commission concluded at page 23 of this order

"Although fully constructed and ready to be put in service, the Commission finds that the plant is actually a reserve for use by future Tega Cay development."

The Commission in TCU did allow the interest and depreciation expense for the outfall lines which were carrying wastewater.

This TCU case is not at all parallel to this Heater case as the Heater cost plant is now and has been used and useful to provide service to existing customers.

Grantmyre Rebuttal Testimony, pp. 6-7.

Witness Grantmyre further supported the Company's adjustment by providing the following testimony:

The replacement cost allowance utilized by the Company

in this case is identical to the allowance approved by the South Carolina Public Service Commission in the Heater Utilities rate case Order dated September 30, 1975, Docket No. 18,053, Order No. 18,694. In this Order the Commission approved the replacement cost allowance as a percentage of the contributed plant in service. The Commission found that a replacement cost allowance on contributed plant should be considered as a proper operating expense in lieu of a depreciation expense resulting from contributed plant.

This September 30, 1975, Commission Order was the first Commission rate case Order for Heater Utilities following the Order dated August 21, 1973, by the Richland County Court of Common Pleas in Heater Utilities v. The South Carolina Public Service Commission. In that court case, the court ruled at page 5

"that the Commission erred in failing to consider depreciation expense resulting from contributed plant and in failing to include contributed plant in the rate base for ratemaking purposes in connection with the subject subdivision."

In Heater's 1978 rate case the Commission again dealt with the issue of replacement cost allowance. The Commission stated in its Order dated October 27, 1978, Docket No. 78-343-W, Order No. 78-589, while the Commission will continue to disallow such an expense for other utilities based on the reasons stated in In Re: Development Service, Inc., Docket No. 77-106-S, the Commission would continue to allow the replacement cost allowance expense for Heater Utilities. The Commission in this October 27, 1978, Heater Order stated the replacement cost allowance was based on the August 21, 1973, judicial decision in the court case of Heater Utilities, Inc. v. South Carolina Public Service Commission, previously described. The Commission stated in this Heater Utilities October 27, 1978, Order, at page five

"While our most recent decisions would require disallowance of the replacement cost allowance, the Commission concludes that the doctrine of estoppel by judgment is applicable, and requires that the Commission consider the Company's proposed replacement cost allowance as a proper operating expense. Davis, Administrative Law Treatise, Section 18.11; See, Mackey v. Frazier, 234 S.C. 81, 106 S.E. 2d, 895 (1959)."

The Commission's October 17 (sic), 1978, Order affirming for Heater Utilities for replacement cost allowance expense is still applicable. The replacement cost allowance should be included in this present case.

Grantmyre Rebuttal Testimony, pp. 8-10.

D. SALARIES AND WAGES ADJUSTMENT

The Consumer Advocate recommended that the Company's proposed increase in operation and maintenance salaries and wages of \$8,097 and general expenses salaries and wages of \$17,523 be rejected and that the Commission order Heater to justify its salaries and wages level. The Consumer Advocate suggested that the 12% and 11% increase in salaries and wages for O&M and general expenses, respectively, should not be allowed unless justified by the Company. According to Mr. Miller the increases "significantly" exceed the rate of inflation and increases given in the utility industry. Miller testimony.

The Company addressed this issue through the rebuttal testimony of witness Hilburn. According to Ms. Hilburn, the total 11.26% increase in salaries and wages is not all from raises issued to Heater employees for 1990. The increase is a result of the annualization of certain salaries and wages that did not have twelve months of expense reflected in per book amounts and a result of a 5.2% overall wage increase effective February, 1991. Ms. Hilburn provided information as to how the calculations were performed. She noted that employees hired during the test year would not have an annual level of salaries and wages expense included in per book amounts and that the replacement of certain

employee positions with others of greater experience would impact the adjustment. Rebuttal testimony of Hilburn.

E. NEGATIVE TAXES

The Consumer Advocate contends that "negative taxes" should not be ignored by the Company in that it allows the Company to receive a windfall profit at some point in time. The Consumer Advocate equates "negative taxes" with loss carryforwards. The Consumer Advocate suggests that such "negative taxes" should be included when determining the adjusted per books operating income. Miller testimony.

F. INTEREST EXPENSE

The Company took issue with the Staff's capital structure used for calculating interest expense. Staff used the capital structure of Minnesota Power and Light Co., the holding company of Topeka Group, Inc., the parent company of Heater. Hearing Exhibit No. 7. The Company used the "target" capital structure of Heater of 65% debt and 35% equity. Mr. Grantmyre testified that it was obligated to pay its interest expense of \$153,000. Grantmyre testimony. Staff's adopted capital structure would only allow Heater to include interest expense of \$99,517. Hearing Exhibit No. 7.

According to witness Parcell, Topeka Group, Inc., is the sole investor in Heater, and Topeka Group, Inc., is owned by Minnesota Power. While Heater provided information that there exists safeguards to prohibit any double leveraging between Minnesota Power and Heater, witness Parcell admitted that there are no such safeguards between Topeka Group and Heater. Mr. Parcell stated

that in his opinion, he did not think any double leveraging would occur between Topeka Group and Heater. Heater may acquire equity and/or debt from Topeka. Testimony of Parcell.

11. The Company's records reflect that after accounting and pro forma adjustments to its operating revenues and expenses, its total income for return is (\$18,039). Application of Company, Revised Exhibit C. The Staff calculated the Company's total income for return, after accounting and pro forma adjustments to be (\$2,130). Hearing Exhibit No. 7, Accounting Exhibit A.

12. The Company has applied for rates which will result in a return on rate base of 9.44%, Application of Company, Revised Exhibit J). Heater requested the Commission to set its rates and charges based upon the return on rate base methodology. Application of Company, Page 2; Grantmyre testimony; Parcell testimony. The applied-for rates would result in an operating margin after interest of 5.48%, according to the Company. Application of Company, Revised Exhibit K.

13. The Commission Staff calculated the rate of return on rate base to be 9.22% and the operating margin, after interest, to be 8.71% under the proposed rates and assuming Staff's adjustments. Hearing Exhibit No. 7.

CONCLUSIONS OF LAW

1. The Company is a water utility providing water service in its service area in South Carolina. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 et seq. (1976), as amended.

2. A fundamental principle of the ratemaking process is the establishment of an historical test year with the basis for calculating a utility's rate base and, consequently, the validity of the utility's requested rate increase. While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expense, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See, Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984), citing City of Pittsburgh v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958); Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978).

3. The Company chose the test year ending December 31, 1990. The Commission Staff used the same test year in calculating its adjustments. The Commission is of the opinion that the test year ending December 31, 1990, is appropriate based on the information available to the Commission. The test year ending December 31, 1990, is the appropriate test year for the purposes of this rate request.

4. The Commission concludes that the Staff's adjustments to the Company's operating revenues are appropriate. The Staff's adjustments recognize the annual level of revenues based on a billing analysis performed by the Company and audited by the Staff, the adjustment of late fees, and the recomputation of reconnection

fees. Accordingly, the Commission finds that the appropriate level of revenues for the Company for the test year under the present rates and after accounting and pro forma adjustments is \$953,925.

5. The Commission also concludes that the Staff's adjustments to the Company's operating expenses are appropriate with one exception. The Commission makes this conclusion based on the following legal principles and reasoning:

A. RATE CASE EXPENSES

The Commission concludes that it is not appropriate to include estimated rate case expenses for ratemaking purposes. The Company provided an exhibit (Hearing Exhibit No. 1) which included supporting vouchers and bills submitted by counsel and its expert witnesses. The Commission concludes that this type of submittal is appropriate and is properly included for ratemaking purposes. The Commission accepts these actual rate case expenses. Amortized over three years and coupled with the other actual rate case expenses accounted for by the Staff and the Consumer Advocate, the total annual amortization for rate case expenses is \$4,249.

B. DEPRECIATION EXPENSE

Based on the Staff's access to the Company's information relating to the accrual rates used by the Company and the depreciable plant amounts at the end of the test year, the Commission finds that sufficient information exists to adopt Staff's adjustments to depreciation expense which are based on appropriate regulatory and accounting treatment.

C. REPLACEMENT COST ALLOWANCE AND EXCESS CAPACITY

The Commission concludes that the Consumer Advocate's proposal to disallow the Company's 23% replacement cost allowance and the depreciation and interest expense on cost plant should be denied. The Company has adequately supported this allowance and any accompanying depreciation and interest through the rebuttal testimony of Mr. Grantmyre. While this may be a novel situation, the record adequately supports the adoption of such an allowance and the denial of the Consumer Advocate's proposal.

D. SALARIES AND WAGES

The Commission has considered the Consumer Advocate's proposal and the information provided by the Company. The Commission finds that the Company has provided sufficient justification for its salaries and wages adjustment. The total increase was only partially a result of wage increases, i.e., 5.2%. The Consumer Advocate has not asserted that a 5.2% wage increase is excessive. Additionally, the Company's explanation concerning new or reassigned employees adequately explains the remainder of the increases in salaries and wages. Because the Company has concurred with Staff's adjustment in this regard, the Staff's adjustment is adopted for ratemaking purposes. Accordingly, the relating payroll tax increases are adopted as sponsored by Staff.

E. NEGATIVE TAXES

The Consumer Advocate's proposal regarding the inclusion of negative taxes is not in harmony with the test year concept. The "snap shot" taken during the twelve months endings December 31, 1990, does not recognize any tax losses previously experienced by the Company that might be carried forward to future tax periods. As oft times is the case, regulatory accounting differs from tax accounting. This is one such instance. The Commission Staff proposed an adjustment to true up income taxes to an "as adjusted" level. The Staff demonstrated that on an as adjusted basis the Company does not have any taxable income and made an adjustment to lower per book income taxes to zero (-0-) for ratemaking purposes. The Commission concludes that Staff's true up adjustment results in the appropriate level of as adjusted income taxes for Heater.

F. INTEREST EXPENSE

The Commission has determined that the capital structure proposed by Staff should be adopted for ratemaking purposes herein. The Company proposes a capital structure which is merely a "target" capital structure, is a fiction created for ratemaking purposes, does not reflect the actual market determined levels of debt and equity and lends itself to double leveraging. Such a capital structure is unrealistic and inappropriate in the Commission's view. Therefore, using Minnesota Power and Light's capital structure as of December 31, 1990, the Company should include \$99,517 as interest expense.

G. OTHER ADJUSTMENTS

The Commission concludes that since there were no objections to the other adjustments proposed by the Commission Staff, that these adjustments, as supported by the record, are appropriate for ratemaking purposes.

5. Accordingly, the Commission concludes that the Company's appropriate operating expenses for the test year, after pro forma and accounting adjustments is \$958,053.

6. The Company's appropriate total income for return for the test year, after accounting and pro forma adjustments is (\$4,128). Based upon the above determinations concerning the accounting and pro forma adjustments to the Company's revenues and expenses, the Commission concludes that the total income for return is as follows:

TABLE A
TOTAL INCOME FOR RETURN

Operating Revenues	\$953,925
Operating Expenses	958,053
Net Operating Income	<u>\$(4,128)</u>
Customer Growth	- 0 -
Total Income for Return	<u><u>\$(4,128)</u></u>

7. Under the guidelines established in the decisions of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in Hope, a utility "has no constitutional rights to profits such as

are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and...that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

8. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rates of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book value in excess of investment, the Commission may decide to use the "operating ratio" and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the net operating income for return by the total operating revenues of the utility. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

The Company proposed that a rate of return methodology be used as a ratemaking determinant. Witness Parcell testified to the appropriateness of the use of a rate of return methodology and the

appropriate cost of capital for the Company. The Commission has considered the issue of applying the operating margin or rate of return methodologies for water utilities on a case-by-case basis. Each utility is unique and requires a separate review and analysis. However, in most cases involving water utilities, the Commission has employed an operating margin approach. The operating margin was used in the last case for Heater. The Commission concludes that no justification for modifying its approach has been adequately put forth in this case. The testimony of witness Grantmyre states that use of an operating margin approach discourages needed upgrades, but the evidence shows that the Company has made \$1.8 million in plant improvements since the last rate case. The Commission is not convinced in this case that the operating margin actually has discouraged the necessary upgrading of the utility system. There is no evidence that neither the Company's financial condition nor its ability to provide adequate service is being hampered by an operating margin approach. The Commission concludes that use of the operating margin is appropriate in this case, but will maintain the option to consider the rate of return on rate base approach in the Company's future rate filings.

Based on the Company's gross revenues for the test year, after accounting and pro forma adjustments under the presently approved schedules, the Company's operating expenses for the test year after accounting and pro forma adjustments, and customer growth, the Company's present operating margin is as follows:

TABLE B
OPERATING MARGIN

BEFORE RATE INCREASE

Operating Revenues	\$953,925
Operating Expenses	958,053
Net Operating Income	<u>\$ (4,128)</u>
Customer Growth	- 0 -
Total Income for Return	<u>\$ (4,128)</u>
Operating Margin (After Interest)	<u>(10.87%)</u>

9. The Commission is mindful of the standards delineated in the Bluefield decision and of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon this Commission to consider not only the revenue requirements of the Company but also the proposed price for the water service, the quality of the water service, and the effect of the proposed rates upon the consumer. See, Seabrook Island Property Owners Ass. v. S.C. Public Service Commission, Op. No. 23351 (Filed Feb. 25, 1991); S.C. Code Ann. §58-5-290 (1976).

10. The three fundamental criteria of a sound rate structure have been characterized as follows:

... (a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is

economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates
(1961), p.292.

11. Based on the considerations enunciated in Bluefield and Seabrook Island and on the fundamental criteria of a sound rate structure as stated in Principles of Public Utility Rates, the Commission determines that the Company should have the opportunity to earn a 4.89% operating margin. In order to have a reasonable opportunity to earn a 4.89% operating margin, the Company will need to produce \$1,149,445 in annual operating revenues.

TABLE C
OPERATING MARGIN

AFTER RATE INCREASE

Operating Revenues	\$1,149,445
Operating Expenses	994,757
Net Operating Income	<u>154,688</u>
Customer Growth	1,076
Total Income for Return	<u>\$ 155,764</u>
Operating Margin (After Interest)	<u>4.89%</u>

12. In fashioning rates to give the Company the required amount of operating revenues so that it will have the opportunity to achieve a 4.89% operating margin, the Commission has carefully considered the concerns of the Company's customers. While only one customer testified at the hearing in opposition to the rate increase and to note problems experienced in her subdivision with the Company's service, the Commission's files contain many letters

of protest. Many of the letters protest the amount of the increase and address service problems in their subdivisions. The service to Oakridge Hunt Club was addressed by witness Grantmyre and the additional well should, according to Mr. Grantmyre, alleviate many of the problems experienced by the Oakridge Hunt Club customers. The Commission notes that the service problems in the previous rate case with the Hermitage and Dutchman Shores subdivisions have been adequately addressed by the Company and virtually eliminated. The Company is encouraged to continue to improve the quality of service it provides its customers. The Commission recognizes that the proposed increase for water customers amounts to a 30.32% increase in the average customer's bill. The rates designed herein consider the quality of the service provided by the Company to its customers and the need for the continuance of the provision of adequate service, as well as the impact of the increase on those customers receiving service and the need for conservation of water resources.

13. The Commission recognizes the capital improvements that have been made, the increase in operating expenses and the additional DHEC requirements. Further, the Commission recognizes the other increased expenses experienced by the Company and that under the current rates, the Company is experiencing a negative operating margin.

14. The Commission concludes that while an increase in rates is necessary, the proposed increase is unreasonable and inappropriate. Accordingly, the Commission will design rates which will increase the base facility charge for meters less than one

inch for water service to \$8.00 per month. All other metered charges for water customers will remain as proposed by the Company. Also, the Company's requested water commodity charge should be reduced to \$3.32 per 1,000 gallons.

15. The Company's proposed reconnection and customer account charges of \$35.00 and \$25.00, respectively. The Commission finds that the proposed rates are unreasonable and that the proposed increase is denied.

16. The Company did not propose a change to its previously approved \$500 tap fee. The Commission makes no finding in that regard.

17. Based on the above considerations and reasoning, the Commission hereby approves the rates and charges as stated in this Order and attached hereto as Appendix A as being just and reasonable. The rates and charges approved are designed in such a manner in which to produce and distribute the necessary revenues to provide the Company the opportunity to earn the approved operating margin.

18. Accordingly, it is ordered that the rates and charges attached on Appendix A are approved for service rendered on or after the date of this Order. The rate schedule is hereby deemed to be filed with the Commission pursuant to S.C. Code Ann. §58-5-240 (1976), as amended.

19. It is ordered that should the approved schedule not be placed into effect before three (3) months after the effective date of this Order, then the approved schedule shall not be charged

without written permission of the Commission. It is further ordered that the Company maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A and B water utilities, as adopted by this Commission.

20. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)

HEATER UTILITIES INC.

Docket No. 91-096-W - Order No. 91-881
OCTOBER 14, 1991
Appendix A

WATER RATES AND CHARGES

Metered Rates

a. Base Facility Charge For Zero Consumption -

<u>Meter Size</u>	<u>Base Monthly Charge</u>
<1.0	\$ 8.00
1.0	\$22.50
1.5	\$45.00
2.0	\$72.00

b. Commodity Charge - \$ 3.32 per 1,000
gal.

Water Reconnection Charge - \$ 30.00

New Customer Account Charge - \$ 22.00

Tap Fee - \$500.00*

*Except as otherwise prohibited by contract approved by the
South Carolina Public Service Commission.